MARKET Perspectives

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of Oppenheimer & Co. Inc.

Website: www.oppenheimer.com/hnhgroup

November 2022

Over the past ten years, U.S. stock markets have been in general, very optimistic. Market optimism was supported by an accommodative Federal Reserve, which kept interest rates at record lows. Low interest rates plus low inflation created ideal conditions for economic growth, and consequently, corporate profitability.

Now, in 2022, the script has flipped. Massive government spending stimulated demand and the Federal Reserve went into overdrive, aggressively hiking interest rates in an attempt to rein in inflation. Aggressive rate hikes combined with high inflation and aggressive spending has created pessimistic markets.

The question remains, where are things headed? The following are key points which are guiding our opinions as to where we are headed.

Inflation – Still Stubbornly High

The Consumer Price Index (CPI) continues to escalate, marking the seventh straight month above 8%. Prices of food, housing, energy, clothing, medical expenses and wages have all increased markedly. A tight labor market has put pressure on businesses to pay higher wages. It's hard to call rising wages a negative, but large wage hikes in today's environment help fuel inflation.

Fed Policy – Highly Reactive

We are experiencing the fastest series of rate hikes since the second half of 1980. The Fed successfully engineered soft landings in the mid-1980s and mid-1990s with its proactive policy. Today, the Fed is in reactive mode. The Fed hasn't publicly given up on a soft landing, but it will need some luck in order to bring inflation back to 2% without causing economic pain.

Earnings – Remains Relatively Strong

Even in the midst of inflation, many companies have been able to deliver positive results. In large, companies have been successful at passing along costs to the consumer. S&P 500 companies are reporting Q3 earnings often surpassing expectations. Even so, inflation will continue to be an underlying problem for companies' profitability and growth prospects. This is particularly true for multinational companies whose profitability is eroded by a stronger dollar, making US produced goods and services more expensive to foreign buyers.

Looking Ahead – Uncertainty High

The economic outlook in the coming months is uncertain. Investors look to the third quarter GDP numbers for clarity. GDP reports look backward in time, and the possibility that we will be in a recessionary period as we go into 2023 is now a

US Consumer Price Index (CPI): A measurement of the average change in prices over time of a fix basket of consumer items: food, clothes, shelter, transportation and entertainment. The Index is calculated monthly by the government to give insight on inflationary or deflationary trends. The Standard and Poor's (S&P) 500 Index is an unmanaged index that tracks the performance of 500 widely held, large-capitalization U.S. stocks. Individuals cannot invest directly in an index. 5072958.1

real possibility. A bit of good news: In January, Social Security recipients will get an 8.7% COLA increase this January, marking the largest increase in 41 years. Unfortunately, for those still in the work force, inflation has now been outpacing nominal wage growth for 18 months straight, meaning that Americans can afford less than they could a year ago, even with increased wages.

As we have said many times before, "this too shall pass." We believe the Fed will be successful in reducing inflation to more acceptable levels and that corporate earnings will resume a more normal growth rate. We are also encouraged to see bond yields getting back to historically normal rates where traditional savers are once again rewarded for investing in bonds.

Thank you for your trust as we work our way through difficult times in the markets. Every sunset brings the promise of a new dawn. We look forward to meeting your needs. Let us know how we can help.

—Jim, Rob, Launa, Reid & Inge

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